SENATE TAXATION
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Guest opinion: Why state's energy policy must change

By Mark Haggerty - 03/10/2009 | Posted: Tuesday, March 10, 2009 11:00 pm

Baseball managers today use statistics such as a player's batting average or a pitcher's success against left-handed hitters to find better players and win more games. The introduction of statistics often went against the intuition of scouts and managers honed over decades.

Statistics can help Montana make better policy decisions, too. Take the example of recent efforts in Helena to raise oil and natural gas taxes.

A key question is whether higher taxes mean less business for Montana. Intuition tells us that a lower tax rate should result in more wells and jobs (a higher "economic batting average"). Headwaters Economics studied the oil and natural gas tax policies of Montana, Wyoming and three other western states to test this wisdom.

Western states have dramatically different tax structures and tax rates, so we expected to see industry move from states with the least favorable tax climates to those with the most favorable. Instead, states with the two highest tax rates, Wyoming and New Mexico, attracted the highest number of drilling rigs and jobs over the last 10 years.

At the beginning of this decade, when oil and natural gas prices were low, Montana decided on tax breaks as a way to generate new production, jobs and tax revenue. Wyoming, facing a $400 million budget deficit, commissioned two academic studies to determine the right course of action and decided against tax breaks. Montana relied on its intuition.

What happened? In Wyoming, oil and natural gas production grew five times more than in Montana; Wyoming created more jobs, and Wyoming collected an extra billion dollars in tax revenue.

In Montana, the tax incentives transferred half a billion dollars from taxpayers to industry with no evidence they created any additional jobs. The $1.5 billion difference between Montana and Wyoming's tax collections did not draw industry from Wyoming to Montana.

So what did Wyoming's analysis uncover that Montana's intuition missed? First, the oil and natural gas industries are not like other firms. They have to go where the resources are and cannot move away if they do not like local policies. So, tax policies that may work to attract manufacturing jobs, or even baseball teams, do not work for natural resource industries.

Wyoming also learned that state production taxes are deductible from federal corporate income taxes. In other words, when industry pays fewer state production taxes, it pays more in federal income tax, and there is little real change in overall tax liability, but the state loses.

Unfortunately, Montana has not learned from its neighbor's experience. Arguments in Helena today rely on the same hunch that taxes are always bad for business. That's too bad, because Montana can take two steps now to improve its tax policy to benefit the economy and fund urgent needs in the state, without hurting industry.

We are the only state in the west today that does not invest some oil and natural gas taxes into a permanent fund (like Montana's coal severance tax trust fund). As a result, funding for basic government services like teacher salaries is exposed to fluctuating energy prices and the booms and busts of the oil and natural gas industry.

In addition, the "tax holiday" — a 12- to 18-month incentive for new drilling — hurts communities where oil and natural gas are extracted. Exploration and development require up-front county-level investments in road infrastructure, public safety and services for employees who move in to work the drilling rigs. Rural towns and counties in eastern Montana do not have significant reserves on hand to facilitate development while waiting up to two years for revenue. The tax holiday puts local governments at financial risk and jeopardizes the quality of local services for existing businesses.

Eliminating the tax holiday and investing revenue wisely will benefit Montana's communities and economy. The good news is that Montana can pursue these reforms and stop losing money each year without risk of driving away industry. Montana must start studying the playing field the way our neighbors do to increase the batting average of all Montanans.

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